

No. 13440.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CALIFORNIA BY-PRODUCTS CORPORATION, E. F. HAVEN,
ARMAND J. PIHLBLAD, and SONNETT SUPPLY Co.,
Appellants,

vs.

FRANK M. CHICHESTER, Trustee in Bankruptcy of the
Estate of Superior Casting Company, Inc., Bankrupt;
BILL LEPPER MOTORS, INC., and CONSOLIDATED CAST-
ING Co.,
Appellees.

BRIEF OF APPELLANTS.

DANIEL W. GAGE and
RUSSELL B. SEYMOUR,
458 South Spring Street,
Los Angeles 13, California,
Attorneys for Appellants.



TOPICAL INDEX

	PAGE
Preliminary statement	1
Statement of pleadings and facts showing jurisdiction.....	2
Statement of the case.....	4
Specification of errors relied upon.....	10
Summary of argument.....	12
Argument.....	14
Preliminary remarks	14
Point I. The referee erred in approving the compromise in the absence of any evidence supporting the petition of the trustee for leave to compromise.....	1
A. To sustain findings and order approving a petition for leave to compromise a controversy, a referee must have received substantial evidence warranting his action.....	1
B. No evidence was received by the referee.....	1
(1) The record is barren of any evidence actually ad- duced at the hearing on the petition to compromise	1
(2) A referee in an adversary proceeding may not con- sider evidence not offered at the hearing.....	1
Point II. The referee erred in approving the compromise without permitting objecting creditors to adduce evidence of the existence of fraud in the conduct of the chattel mortgage foreclosure	1
A. The referee should have permitted the objecting credi- tors to present evidence to support their objections to the proposed compromise.....	1

Point V. The referee erred in finding that a controversy existed between the trustee and Consolidated Casting Company and Bill Lepper Motors, Inc., for the reason that no collection of a deficiency can be made by a mortgage on an obligation secured by a chattel mortgage which has been improperly or fraudulently foreclosed.....	19
A. Unless there be a substantial controversy, the referee may not approve a petition to compromise.....	19
B. A fraudulently conducted chattel mortgage foreclosure bars recovery of any deficiency under the obligation secured by the chattel mortgage.....	19
A sale having been improperly conducted, no collection of any deficiency can be had.....	20
C. Proof by the objecting creditors of fraudulent foreclosure bars recovery of any deficiency under the obligation secured by the chattel mortgage.....	22
D. There is no proof or intimation of proof that the chattel mortgage foreclosure sale was not fraudulently conducted	22
Point III. The referee erred in considering as evidence numerous documents and testimony not adduced at the hearing on the petition to compromise.....	22
A. A referee in an adversary proceeding may not consider evidence not offered at the hearing.....	22
Point IV. The referee erred in refusing to consider the objections of appellants unless they first would deposit as indemnity the sum of \$21,500.00.....	23
Conclusion	23
Appendix:	
Reporter's Transcript of Proceedings on Hearing on Petition to Compromise Controversy.....	App. p. 1

TABLE OF AUTHORITIES CITED

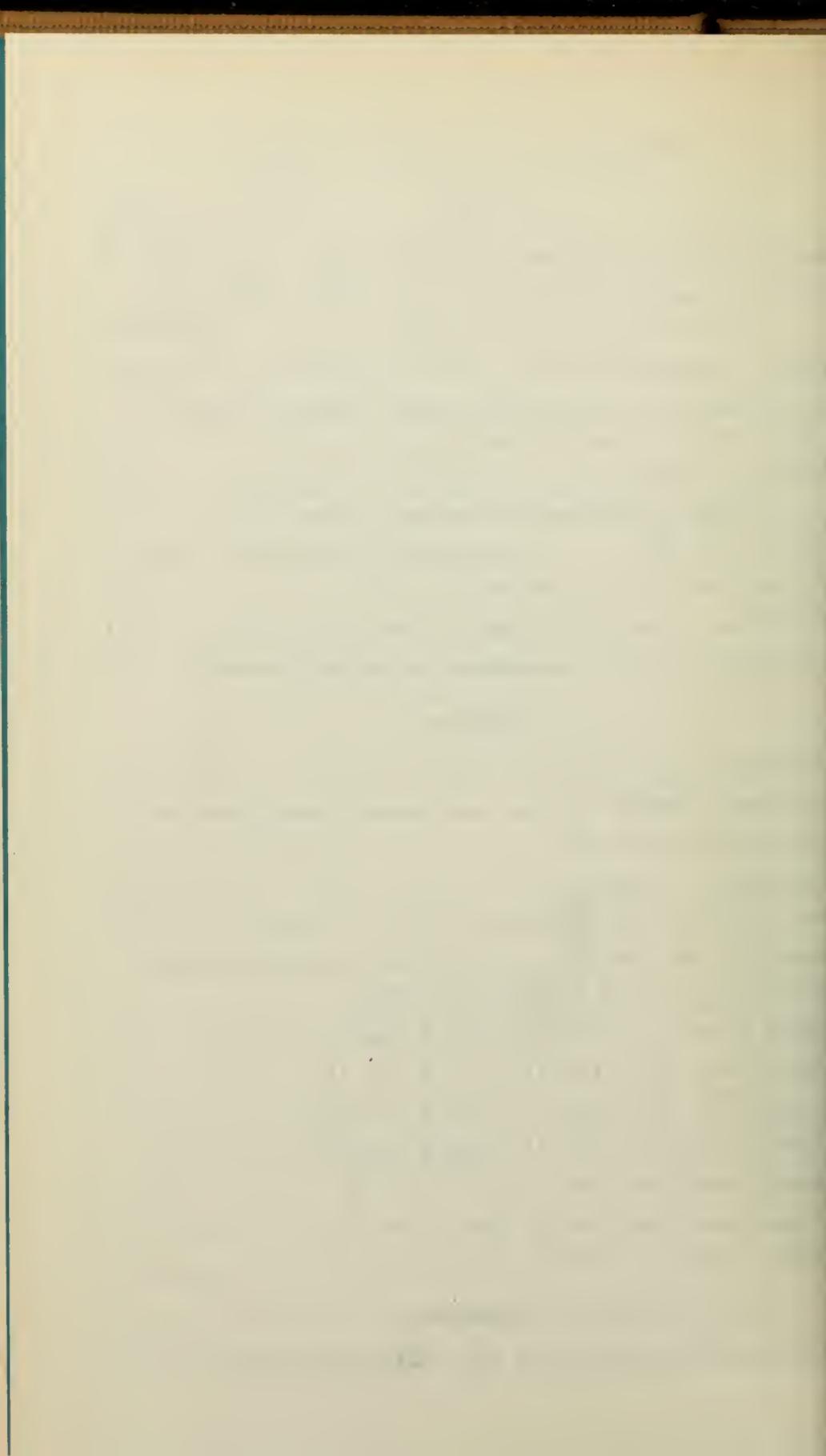
CASES	PAGE
Aughenbaugh, In the Matter of, 125 F. 2d 887.....	16, 18
California Associated Products Co., In re, 183 F. 2d 946.....	15, 18, 19
Coon v. Shry, 209 Cal. 615.....	21
George-Grenatti Associates, Inc., In the Matter of, 26 Fed. Supp. 952	17
Metheny v. Davis, 107 Cal. App. 137.....	20
Niagara Falls Milling Company, Bankrupt, In the Matter of, 34 Fed. Supp. 801.....	15, 18
Peppers Fruit Co., In re, 24 Fed. Supp. 119.....	15, 18
Trowbridge v. Love, 58 Cal. App. 2d 746.....	21
Truscott Boat & Dock, In the Matter of, 92 Fed. Supp. 430.....	19

STATUTES

Bankruptcy Act, Sec. 1(10)	4
Bankruptcy Act, Sec. 2a.....	4
Bankruptcy Act, Sec. 24.....	4
Bankruptcy Act, Sec. 38.....	4
Bankruptcy Act, Sec. 39c	3, 4
Bankruptcy Act, Sec. 59.....	2
Federal Rules of Civil Procedure, Rule 73g	3
United States Code, Title 11, Chap. 1, Sec. 1.....	4
United States Code, Title 11, Chap. 2, Sec. 11.....	4
United States Code, Title 11, Chap. 4, Sec. 47.....	4
United States Code, Title 11, Chap. 5, Sec. 66.....	4
United States Code, Title 11, Chap. 5, Sec. 67	3, 4
United States Code, Title 11, Chap. 6, Sec. 95.....	2
United States Code, Title 28 (new), Sec. 1291.....	4

TEXTBOOKS

2 Collier on Bankruptcy (14th Ed), 1951 Supp., p. 101.....	19
--	----



No. 13440.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CALIFORNIA BY-PRODUCTS CORPORATION, E. F. HAVEN,
ARMAND J. PIHLBLAD, and SONNETT SUPPLY Co.,
Appellants,

vs.

FRANK M. CHICHESTER, Trustee in Bankruptcy of the
Estate of Superior Casting Company, Inc., Bankrupt;
BILL LEPPER MOTORS, INC., and CONSOLIDATED CAST-
ING Co.,

Appellees.

BRIEF OF APPELLANTS.

Preliminary Statement.

This is an appeal by certain objecting creditors from a Minute Order and a formal order of the District Court of the United States, Southern District of California, Central Division, affirming an order of the Referee in Bankruptcy authorizing Frank M. Chichester, as Trustee in the Matter of Superior Casting Company, Inc., Bankrupt, to compromise a controversy between himself and Bill Lepper Motors, Inc., and Consolidated Casting Company, by which, among other things, the Trustee was to pay to Bill Lepper Motors, Inc., the sum of \$63,444.07 and to receive from Consolidated Casting Company the sum of \$20,000.00.

The appeal involves the questions of whether a Referee may make such an order in the face of written objections filed by creditors (1) without taking any evidence in support of the Trustee's petition, or (2) without permitting the objecting creditors to adduce any evidence in support of their objections, or (3) whether the Referee may summarily approve the proposed compromise unless the objecting creditors would deposit an indemnity to the estate in the amount of \$21,500,00, and (4) whether there existed any legal controversy capable of being compromised.

Statement of Pleadings and Facts Showing Jurisdiction.

The bankruptcy was commenced on February 19, 1951, in the District Court of the United States, Southern District of California, Central Division, by the filing of a creditors' petition against the bankrupt herein, Superior Casting Company, Inc., a California corporation, under the provisions of Section 59 of the Bankruptcy Act. (11 U. S. Code, Chap. 6, Sec. 95.) [3]* Further proceedings were immediately referred generally to Reuben G. Hunt, Referee in Bankruptcy. [7] The corporation was adjudged bankrupt on April 13, 1951. [8] On June 14, 1951, Frank M. Chichester became the duly appointed, qualified and acting Trustee in Bankruptcy herein. [9] On June 14, 1951, an order was made by the Referee directing a sale by the Trustee of certain real property of the bankrupt free and clear of any lien asserted against the property by Bill Lepper Motors, Inc., and transferring such lien to the proceeds of such sale. [55, 57] On July 27, 1951, an order was made confirming a sale of said

*Indicates page of printed transcript of record.

real property for the sum of \$75,000.00. [59] On October 15, 1951, the Trustee in Bankruptcy filed his petition for leave to compromise a controversy between himself and Bill Lepper Motors, Inc., and Consolidated Casting Company. [119] A hearing on the petition was had on October 30, 1951 [252], at which time the appellants filed written objections to the proposed compromise. [128] On November 15, 1951, Findings of Fact, Conclusions of Law and an Order approving the proposed compromise and overruling the objections of the appellants were entered by the Referee. [144] On November 23, 1951, appellants filed a petition for review under the provisions of Section 39c of the Bankruptcy Act (11 U. S. Code, Chap. 5, Sec. 67). [152] On February 8, 1952, the Referee filed his Certificate [14], and on February 15, 1952, filed a supplemental Certificate. [166] The petition for review was heard by a Judge of the United States District Court which on April 4, 1952, made and entered its Minute Order affirming the order of the Referee [272], and on April 16, 1952, made and entered its formal written order affirming the order of the Referee. [273] On May 2, 1952, notice of appeal from each of said orders [274] and a bond in the amount of \$250.00 for costs on appeal [275] were filed by appellants. On June 9, 1952, an order was made by the District Court of the United States, pursuant to rule 73g of the Federal Rules of Civil Procedure extending to July 1, 1952, the time for filing of the record on appeal with this Court and for docketing therein the within appeal. [278] The record on appeal was filed and docketed June 24, 1952. [281] A statement of points was filed by appellants in this Court on July 16, 1952. [282]

The jurisdiction of the District Court of the United States was invoked upon the filing of the creditors' petition against the bankrupt in the United States District

Court for the Southern District of California, Central Division (Sec. 1 (10) of the Bankruptcy Act, 11 U. S. Code, Chap. 1, Sec. 1, and Sec. 2a of the Bankruptcy Act, 11 U. S. Code, Chap. 2, Sec. 11). The jurisdiction of the Referee in Bankruptcy was invoked by the general order of reference. (Bankruptcy Act, Sec. 38, 11 U. S. Code, Chap. 5, Sec. 66.) Jurisdiction of the District Court of the United States in respect to the petition for review is covered by Section 2a, subdivision 10, of the Bankruptcy Act (11 U. S. Code, Chap. 2, Sec. 11), and Section 39c of the same Act. (11 U. S. Code, Chap. 5, Sec. 67.) The jurisdiction of the United States Court of Appeals for the Ninth Circuit was invoked under Section 24 of the Bankruptcy Act (11 U. S. Code, Chap. 4, Sec. 47, and also by New Title, 28 U. S. Code, Sec. 1291).

Statement of the Case.

Superior Casting Company, Inc., the bankrupt, was adjudged bankrupt on April 13, 1951 [8], as a consequence of an involuntary petition filed February 19, 1951. [3] On June 14, 1951, Frank M. Chichester became the Trustee in Bankruptcy. [9] On the same day an order was made by the Referee in Bankruptcy to whom the matter had been referred directing a sale by the Trustee of certain real property of the bankrupt free and clear of the lien of a deed of trust held by Bill Lepper Motors, Inc., one of the appellees, and transferring the lien to the proceeds of such sale. [55] On July 27, 1951, a sale of the property was made by the Trustee for \$75,000.00. [59] On September 11, 1951, Bill Lepper Motors, Inc., filed a petition requesting payment to it by the Trustee in Bankruptcy of \$64,944.07 alleged to be due it on account of said lien. [91] On September 25, 1951, the Trustee filed an answer to said petition [94]

denying generally the various allegations of the petition and setting forth certain defenses: (1) that the amount owing did not exceed \$61,609.78 [94-97]; (2) that at a date prior to bankruptcy Bill Lepper Motors, Inc., had sold for \$1,500.00 under chattel mortgage foreclosure certain personal property worth \$20,000.00 [97-99]; (3) that one Aleidis, purchaser of the real property from the bankrupt estate, was an agent for Bill Lepper Motors, Inc. [99]; (4) that Bill Lepper Motors, Inc., had converted certain other personal property of the value of \$5,000.00 [99-100]; (5) that Bill Lepper Motors, Inc., and the bankrupt had arranged for the former to acquire the obligation of the bankrupt secured by the Deed of Trust and Chattel Mortgage and then to take over the business of the bankrupt through the agency Consolidated Casting Company, an adjunct of Bill Lepper Motors, Inc., at the expense of the bankrupt's creditors [100-101], and (6) that Bill Lepper Motors, Inc., acquired the obligation and Deed of Trust as agent of the bankrupt. [101]

Pursuant to order dated September 28, 1951 [110], the appellants also filed an answer and counterclaim to said petition the benefits of which were to redound to the estate in bankruptcy. [111] In said answer, among other things, it was alleged that the monies assertedly owing to Bill Lepper Motors, Inc., under its Deed of Trust were based upon the same obligation that was also secured by the aforesaid Chattel Mortgage [112] and that Bill Lepper Motors, Inc., on December, 1950, purportedly foreclosed the Chattel Mortgage under a sale at which "certain bidders made an opening bid on the said property in the amount of \$5,000.00, which bid was increased by petitioner (Bill Lepper Motors, Inc.) or its nominee, and the opening bidder in successive advances of \$500.00

each, until a bid of \$9,000.00 was made by the original bidder. At this point, the petitioner or its agent paid to the original bidder the sum of \$1,000.00 in consideration of the original bidder withdrawing his bid and refraining from further bidding. All previous bids were withdrawn and another bid in the amount of \$1,500.00 was made by the petitioner, or its nominee, and the property was purportedly sold to the petitioner, or its nominee, for the sum of \$1,500.00 which amount petitioner is endeavoring to credit the obligation of the bankrupt to the petitioner." [116]

A trial of the matter was commenced on October 2, 1951 [168], at which time the Referee refused to permit appellants to participate in the hearing.

"The Referee: Do you want this creditor to collaborate with you?

Mr Blonder: I don't need him, your Honor. As far as I am concerned, Mr. Seymour and Mr. Gage have done nothing but obstruct what the Trustee is attempting to do.

The Referee: That is my view of it." [171]

"Mr. Seymour: The Trustee, I understand, has enumerated his defenses to that trust deed and to the chattel mortgage. Now, on behalf of the creditors that have filed an answer here I would like to point out two theories of law—

The Referee: I am not going to hear you on behalf of the creditors unless the Trustee want to collaborate with you." [186]

"Mr. Seymour: Your Honor, there has been filed before this Court a document which if it be correct in my opinion makes an adverse interest between the counsel for the Trustee and these persons.

The Referee: All right, I don't care about your opinions. You have got to point that out by some

proceeding. I am not going to permit you to come in and ball up this proceeding, Mr. Seymour, unless there is ground for it." [186]

"Mr. Gage: I move the witness' answer be stricken as not responsive.

The Referee: I am not going to hear from you. Motion denied. If the Trustee wants to make that, all right. You have to work through the Trustee, unless you show the Trustee isn't doing his duty." [209]

The trial was continued until October 4, 1952, after Bill Lepper Motors, Inc., had presented its *prima facie* case. [218]

After partial cross-examination of William S. Lepper, President of Bill Lepper Motors, Inc. [219-250] and before the matter was concluded [250] the entire matter was continued to November 1, 1952, with the intention that a petition to compromise would be heard in the interim. [250]

The petition to compromise [119] was filed by the Trustee, objections thereto were filed by the appellants [128], and a hearing had on October 30, 1951. [252-271] The reporter's transcript thereof is printed in the appendix. In substance some of the grounds for said objections [129] were:

(1) That the fraudulent sale under the chattel mortgage referred to in said petition* absolutely

*(*I. e.*, "that the said foreclosure sale was fraudulent and false and improperly conducted; that bidding was stifled at said sale; that the creditors of Superior Casting Company and the Trustee herein were damaged by said improper foreclosure sale to the extent that the credit that Bill Lepper Motors, Inc., should have allowed against its claim under the Trust Deed as aforesaid, should not have been the sum of \$1,500.00 but should have been the actual value of the personal property foreclosed upon by Bill Lepper Motors, Inc., by said chattel mortgage foreclosure sale, plus certain supplies converted at said sale." [123])

eliminates any deficiency in favor of the obligation now held by Bill Lepper Motors, Inc., to wit: the asserted claim of Bill Leppers Motors, Inc., based on the Deed of Trust referred to in said petition of the Trustee. [129]

(2) That certain named witnesses had not been examined fully or in some cases at all in respect to the asserted fraud. [129]

(3) That the proposed compromise was not to the best interests of the estate. [130]

At the hearing held on October 30, 1951,

(1) The Trustee failed to adduce any evidence in support of his petition (unless perchance through the medium of "judicial notice"); see Reporter's Transcript, pages 252-271 set out in appendix, and paragraph II of Referee's Certificate [21].

(2) The Referee refused to permit the objecting creditors to adduce any evidence in support of their objections. See Reporter's Transcript at pages 267, 268, 270 (Appendix). See also Referee's Certificate [21];

(3) The Referee summarily refused to deny the petition to compromise unless the objecting creditors would deposit an indemnity to the estate to the extent of at least \$21,500.00. See Referee's Certificate. [21] See also Reporter's Transcript at pages 252, 253, 254, 256, 258, 260 and 267. (Appendix.)

The order in question was made by the Referee on November 15, 1952. [144]

The Petition for Review was filed November 23, 1952. [152]

After the Petition for Review had been filed, the Referee orally required the appellants to obtain and file reporter's transcript of the partially completed proceeding held on the petition of Bill Lepper Motors, Inc., October 2 and 4, 1952, as a condition to the Referee preparing his Certificate on Review. (This requirement does not appear in the record, but it will be noted that the Reporter's Certificate on the transcript was made December 28, 1951 [251], the transcript was filed with the Referee on January 3, 1952 [251] and the Referee's Certificate was dated and filed February 8, 1952. [26].)

On February 8, 1952, the Referee's Certificate was filed and made a part of it were thirty-two different documents from the files of the entire bankruptcy proceeding. These are listed in Paragraph VI of the Certificate [23-26] and are printed at pages 26-165. None of these documents had been introduced into evidence at the hearing of October 30, 1951. [252-271]

On February 15, 1952, the Referee filed a Supplemental Certificate [166] and incorporated therein the reporter's transcript of the hearings had October 2 and 4, 1952, in connection with the petition of Bill Lepper Motors, Inc. [167-251] and the reporter's transcript of the hearing on October 30, 1952, in connection with the Petition to Compromise. [252-271] No part of the testimony adduced at the October 2, 1952, and October 4, 1952, hearings had been placed in evidence at the October 30, 1952, hearing on the Petition to Compromise. [252-271]

On April 4, 1952, the District Court entered its Minute Order [272] and on April 16, 1952, entered its formal order, affirming the order of the Referee. [273]

SPECIFICATION OF ERRORS RELIED UPON.

I.

The Referee Erred in Approving the Compromise in the Absence of Any Evidence Supporting the Petition of the Trustee for Leave to Compromise.

(No evidence was introduced at the hearing of the petition to compromise. See Referee's Certificate, paragraph II [21]; reporter's transcript of hearing. [252-271].)

II.

The Referee Erred in Approving the Compromise Without Permitting Objecting Creditors to Adduce Evidence of the Existence of Fraud in the Conduct of the Chattel Mortgage Foreclosure.

(The objecting creditors offered evidence in support of their written objections and at the hearing offered to prove by witnesses Smith, Scherer and Faulkenberg that the foreclosure of the chattel had been fraudulently conducted by stifled bidding in that after the bidding on the property involved had reached the sum of \$9,000.00, Consolidated Casting Company and the agents in charge of the sale paid the only other bidder \$1,000.00 not to make a bid; that the \$9,000.00 bid was then withdrawn and the property sold to Consolidated Casting Company for \$1,500.00, which was the amount credited on the obligation, the remainder of which is the subject matter of the present proceeding. This offer was refused by the Referee. Referee's Certificate, paragraph II [21]; Reporter's Transcript [256, 266, 267, 268 and 269]. The

attorney for the Trustee stated that in his opinion the testimony offered would show that the sale under the chattel mortgage was, in essence, fraudulent. [266]. In addition the Referee stated that he was not concerned with any evidence of fraud and made that his order. [267, 270])

III.

The Referee Erred in Considering as Evidence Numerous Documents and Testimony Not Adduced at the Hearing on the Petition to Compromise.

(These documents consisted of thirty-two items listed in paragraph VI of the Referee's Certificate [23-26] and are printed at pages 26-165. He likewise, considered the Reporter's Transcript of October 2 and 4, 1952. [167-251].)

IV.

The Referee Erred in Refusing to Consider the Objections of Appellants Unless They First Would Deposit as Indemnity the Sum of \$21,500.00.

V.

The Referee Erred in Finding That a Controversy Existed Between the Trustee and Consolidated Casting Company and Bill Lepper Motors, Inc., for the Reason That No Collection of a Deficiency Can Be Made by a Mortgagee on an Obligation Secured by a Chattel Mortgage Which Has Been Improperly or Fraudulently Foreclosed.

SUMMARY OF ARGUMENT.

POINT I.

The Referee Erred in Approving the Compromise in the Absence of Any Evidence Supporting the Petition of the Trustee for Leave to Compromise.

- A. To sustain findings and order approving a petition for leave to compromise a controversy, a Referee must have received substantial evidence warranting his action.
- B. No evidence was received by the Referee.
 - (1) The record is barren of any evidence actually adduced at the hearing on the petition to compromise.
 - (2) A Referee in an adversary proceeding may not consider evidence not offered at the hearing.

POINT II.

The Referee Erred in Approving the Compromise Without Permitting Objecting Creditors to Adduce Evidence of the Existence of Fraud in the Conduct of the Chattel Mortgage Foreclosure.

- A. The Referee should have permitted the objecting creditors to present evidence to support their objections to the proposed compromise.

POINT V.

The Referee Erred in Finding That a Controversy Existed Between the Trustee and Consolidated Casting Company and Bill Lepper Motors, Inc., for the Reason That No Collection of a Deficiency Can Be Made by a Mortgagee on an Obligation Secured by a Chattel Mortgage Which Has Been Improperly or Fraudulently Foreclosed.

- A. Unless there be a substantial controversy, the Referee may not approve a petition to compromise.
- B. A fraudulently conducted chattel mortgage foreclosure bars recovery of any deficiency under the obligation secured by the chattel mortgage.
- C. Proof by the objecting creditors of fraudulent foreclosure if uncontroverted by substantial evidence would have rendered it improper for the Referee to find that a controversy existed, capable of compromise.
- D. There is no proof or intimation of proof that the chattel mortgage foreclosure sale was not fraudulently conducted.

POINT III.

The Referee Erred in Considering as Evidence Numerous Documents and Testimony Not Adduced at the Hearing on the Petition to Compromise.

- A. A Referee in an adversary proceeding may not consider evidence not offered at the hearing.

POINT IV.

The Referee Erred in Refusing to Consider the Objections of Appellants Unless They First Would Deposit as Indemnity the Sum of \$21,500.00.

The action of the Referee was abuse of discretion since no evidence had been received in support of or in opposition to the proposed compromise.

ARGUMENT.

Preliminary Remarks.

1. The appellants have no quarrel with the general proposition that a Referee in Bankruptcy may in his sole discretion, legally exercised, authorize a compromise of a controversy between a Trustee and a third person and that the Referee's decision should not be set aside except for clear error or abuse of discretion.

We suggest, however, and shall endeavor to demonstrate as applicable to these proceedings, that before a Referee shall exercise his discretion he must have before him at least some evidence which will permit him to find that a substantial controversy does exist and then, having made that finding, to find that the proposed compromise will be to the best interests of the estate.

2. The record in this case is, in our opinion, unduly lengthy, being some two hundred eighty-three pages. Part of the reason may be our fault. If so, we apologize. However, as may be observed, the Referee attached to his Certificate on Review [23] thirty-two documents [26-165] none of which had been introduced or offered into evidence at the compromise hearing; and as part of a supplemental Certificate on Review [166] filed a Reporter's Transcript of hearing had on October 2 and 4, 1951 [167-251], which had not been introduced or offered into evidence at the compromise hearing on October 30, 1951, and which, so far as we can see, bears no relationship to the compromise.

Fearful that we might be charged with failure to produce all evidence taken before the trial court, we caused the entire record, as claimed by the Referee, to be filed

in this Court. We did endeavor to print in narrative form a major portion of the Reporter's Transcript, but the appellees insisted upon the literal transcript.

POINT I.

The Referee Erred in Approving the Compromise in the Absence of Any Evidence Supporting the Petition of the Trustee for Leave to Compromise.

A. To Sustain Findings and Order Approving a Petition for Leave to Compromise a Controversy, a Referee Must Have Received Substantial Evidence Warranting His Action.

In re California Associated Products Co., 183 F. 2d 946, decided by this Court August 12, 1950, a matter involving a compromise of a controversy, the order of the District Court was reversed because the Judge had made findings different from those of the Referee *without taking additional testimony*.

In re Peppers Fruit Co., 24 Fed. Supp. 119, the Court reversed an order of the Referee approving a compromise because no evidence had been presented by the Trustee to support his petition. The Court there stated "in these compromise matters, where objection is made, even by only a small creditor, substantial evidence should be produced by the opposing parties in order that the Referee may carefully consider the merits or demerits of the proposed compromise."

In *In the Matter of Niagara Falls Milling Company, Bankrupt*, 34 Fed. Supp. 801, the Court reversed the order of the Referee approving a compromise because no evidence had been submitted before the Referee to show

the basis and the reasonableness of the compromise. This was done even though the objecting creditor did not ask for an examination before the Referee.

B. No Evidence Was Received by the Referee.

- (1) THE RECORD IS BARREN OF ANY EVIDENCE ACTUALLY ADDUCED AT THE HEARING ON THE PETITION TO COMPROMISE.

The Referee in his Certificate on Review states that no evidence was received (other than certain documents of which the Referee took "judicial notice"). [21] Reference is made also to the Reporter's Transcript of the hearing of October 30, 1951, set out in the appendix. [252-271]

- (2) A REFEREE IN AN ADVERSARY PROCEEDING MAY NOT CONSIDER EVIDENCE NOT OFFERED AT THE HEARING.

The correct rule respecting the area included in "judicial notice" is set out in *Matter of Aughenbaugh*, 125 F. 2d 887, where, as here, a mortgagee was endeavoring to obtain the amount of his claim from proceeds of a sale of real estate free and clear. In view of the similarity of facts, we quote freely from that case.

"In passing upon this question we may consider only the evidence which was presented to the referee at the hearing upon the trustee's exceptions to the mortgagee's priority claim. We may not consider other evidence which may have been in the files of the referee in the bankruptcy administration proceeding. To hold otherwise would be to violate the fundamental concept of procedural due process that a party to litigation is entitled to have the evidence relied upon by his opponent presented at the hearing

of his case so that he may have opportunity to cross-examine his opponent's witnesses and to offer evidence in rebuttal.

“Although the exceptions of the trustee to the priority claim of the mortgagee were filed in the general bankruptcy proceeding they raised a distinct controversy for determination by the referee which it was his duty to treat as an independent litigation, summary in form it is true, and to consider solely upon the evidence presented at the trial of that issue. If the Trustee desired to rely upon any papers already on file in the bankruptcy proceeding it was incumbent upon him to offer them at the hearing of his exceptions in order that the mortgagee might know that they were being relied upon and might have an opportunity to meet them with such other evidence as might be available to it.”

“Our examination of the record indicates that the referee reached his decision from a consideration not only of the evidence offered at the hearing upon the trustee's exceptions but also of the bankruptcy schedules, the official appraisal, the proofs of claim, the return of sale and perhaps other papers on file in the bankruptcy administration proceeding, none of which was offered in evidence. It is true that the papers in this file so far as relevant would have been admissible as court records without other proof and would if offered in evidence have constituted some evidence of the facts to which they related. But the facts to which they related, being disputed in the very controversy under consideration, were not the sort of facts of which the referee was entitled to take judicial notice.”

See *Matter of George-Grenatti Associates, Inc.*, 26 Fed. Supp. 952, where the Court reversed the Referee because, among other reasons, the Referee considered testi-

mony heard earlier and not referred to at the hearing and stated that a compromise would be a futility if the Referee may base his approval of the compromise on matters already known to him but not brought out at the meeting and that the Referee should have confined himself to facts stated in the petition and facts developed at the meeting.

POINT II.

The Referee Erred in Approving the Compromise Without Permitting Objecting Creditors to Ad-duce Evidence of the Existence of Fraud in the Conduct of the Chattel Mortgage Foreclosure.

A. The Referee Should Have Permitted the Objecting Creditors to Present Evidence to Support Their Objections to the Proposed Compromise.

In re Peppers Fruit Company, 24 Fed. Supp. 119, *supra*, the Court stated that the Referee should "receive and consider such competent evidence relating to the subject matter of these two pieces of litigation as may be presented by the parties sponsoring or opposing the proposed compromise."

In re California Associated Products Co., 183 F. 2d 946, *supra*, it is evident that the Court contemplated that evidence should be received by the parties favoring or objecting to the compromise in order that the Court might make appropriate findings that a compromise existed and that the approval thereof to be to the best interests of the estate.

In the *Matter of Niagra Falls Milling Company, Bankrupt*, 34 Fed. Supp. 801, *supra*, the Court in reversing the Referee stated that the objecting creditors could present such testimony as might be advisable.

See also:

Matter of Aughenbaugh, 125 F. 2d 887, *supra*.

POINT V.

The Referee Erred in Finding That a Controversy Existed Between the Trustee and Consolidated Casting Company and Bill Lepper Motors, Inc. for the Reason That No Collection of a Deficiency Can Be Made by a Mortgage on an Obligation Secured by a Chattel Mortgage Which Has Been Improperly or Fraudulently Foreclosed.

A. Unless There Be a Substantial Controversy, the Referee May Not Approve a Petition to Compromise.

See *Truscott Boat & Dock*, 92 Fed. Supp. 430, where even though a full hearing had been had in respect to the merits of a petition in reclamation the District Court reversed the Referee because the evidence presented showed conclusively that a certain chattel mortgage was void as against the trustee.

Collier on Bankruptcy, 14th Ed. page 101 of 195 Supp. to Vol. II, comments on the *Truscott* case as follows:

“However, wherever there is no controversy and compromise because the material facts and the applicable law are clearly established, approval of a purported compromise is an abuse of discretion.”

See also *In re California Associated Products Co.*, 18 F. 2d 946, *supra*, where this Court reversed the District Court and affirmed the Referee in Bankruptcy only because controverted evidence existed.

B. A Fraudulently Conducted Chattel Mortgage Foreclosure Bars Recovery of Any Deficiency Under the Obligation Secured by the Chattel Mortgage.

The objecting creditors in their objections [129] included by reference the Trustee's statements in his petition for leave to compromise [122-123], statements to the effect

fect that the amount being claimed by Bill Lepper Motors, Inc., was the remainder of an obligation originally secured by a chattel mortgage and by a deed of trust and that the foreclosure sale under the chattel mortgage had been fraudulently conducted and that the bidding thereat had been stifled. As previously pointed out, the Referee's refused to hear any evidence in this connection. Referee's Certificate, paragraph II [21], Reporter's Transcript [256, 266, 267, 268 and 269]. The attorney for the Trustee stated that in his opinion the testimony offered would show that the sale under the chattel mortgage was, in essence, fraudulent [266] and the Referee stated that he was not concerned with any evidence of fraud and made that his order. [267, 270]

At no place has the Trustee even intimated that any evidence to the contrary would or could be adduced. Therefore, our discussion will be premised on the assumption that the chattel mortgage foreclosure sale was fraudulently conducted.

A SALE HAVING BEEN IMPROPERLY CONDUCTED, NO COLLECTION OF ANY DEFICIENCY CAN BE HAD.

Metheny v. Davis, 107 Cal. App. 137, appears to be the leading case on this point and holds squarely that under similar condition, as in this case, a mortgagee can not recover on any balance owing under the original obligation.

This would be true even though the remaining obligation existing after foreclosure of the chattel mortgage co-

incidentally were secured by a deed of trust. See *Trowbridge v. Love*, 58 Cal. App. 2d 746, where the Court denied enforcement of a deed of trust and stated:

“If the deed of trust should be enforced, the cancellation of the note would be of no consequence. It would mean that the decree cancelled the indebtedness but that it must be paid to the Cyrus estate despite that fact.”

To paraphrase the quoted portion of the *Trowbridge* case, we say:

“If the deed of trust should be enforced, the fraudulent foreclosure would be of no consequence. It would mean that the fraudulent foreclosure prevented a deficiency but that the deficiency must be paid to Bill Lepper Motors, Inc., despite that fact.”

See also *Coon v. Shry*, 209 Cal. at 615, where the Court said:

“The situation seems to be a point of first impression, not only in this jurisdiction, but in any other, no case having been found directly in point, where a mortgage was given as security for such a gift. However, we have no hesitancy in holding, in accordance with well-settled principles, that the mortgage must stand or fall with the note. It is well settled in California that a mortgage or mortgage lien is a mere incident of the debt or obligation which it is given to secure. (Cal. Civ. Code, sec. 2909; 17 Cal. Jur. 710, sec. 27, and cases cited in footnote 11.) There cannot be a mortgage if there is no debt or other obligation to be secured. (*Holmes v. Warren*, 145 Cal. 457, 463 (78 Pac. 954); *Todd v. Todd*, 164 Cal. 255, 258 (128 Pac. 413); *Ahern v. McCarthy*, 107 Cal. 382, 386 (40 Pac. 482).) A

mortgage in California has no existence independent of the thing secured by it. (Estate of Fair, 128 Cal. 607, 613 (61 Pac. 184); People v. Eastman, 25 Cal. 601, 603.) As distinguished from the debt the mortgage has no determinate value. (Nagle v. Macy, 9 Cal. 426.)

From the above analysis it necessarily follows that since the note, evidencing the debt, is void, being a mere unenforceable promise to make a gift in the future, the mortgage must fall with the note, and must be declared to be void.”

C. Proof by the Objecting Creditors of Fraudulent Foreclosure Bars Recovery of Any Deficiency Under the Obligation Secured by the Chattel Mortgage.

We believe that this portion of the argument has been covered in Point B above.

D. There Is No Proof or Intimation of Proof That the Chattel Mortgage Foreclosure Sale Was Not Fraudulently Conducted.

At no point has the Trustee urged that the chattel mortgage foreclosure sale was not fraudulently conducted and he has not urged that there was any proof to the contrary.

POINT III.

The Referee Erred in Considering as Evidence Numerous Documents and Testimony Not Adduced at the Hearing on the Petition to Compromise.

A. A Referee in an Adversary Proceeding May Not Consider Evidence Not Offered at the Hearing.

This point, we believe, is covered under Point I, B, (2).

POINT IV.

The Referee Erred in Refusing to Consider the Objections of Appellants Unless They First Would Deposit as Indemnity the Sum of \$21,500.00.

The action of the Referee was abuse of discretion since no evidence had been received in support of or in opposition to the proposed compromise.

This point is only a corollary to the proposition that the Trustee must receive evidence in favor of or against a proposed compromise.

We will concede that if the Referee had first accepted testimony of sufficient character to permit him to approve the compromise, then in the alternative he might have made his order denying the petition on condition that the objecting creditors would indemnify the estate.

Conclusion.

Appellants urge that the orders of the District Court and of the Referee from which this appeal is taken should be reversed.

Respectfully submitted,

DANIEL W. GAGE and
RUSSELL B. SEYMOUR,

By RUSSELL B. SEYMOUR,

Attorneys for Appellants.





APPENDIX.

252 *California By-Products Corp., et al.,*

[Title of District Court and Cause.]

REPORTER'S TRANSCRIPT OF PROCEEDINGS ON HEARING ON PETITION TO COMPROMISE CONTROVERSY

Appearances:

For the Trustee:

DAVID BLONDER, ESQ.

For Bill Lepper Motors:

ROBERT H. SHUTAN, ESQ.

For Certain Creditors:

RUSSELL B. SEYMOUR, ESQ.

For Certain Creditors:

DANIEL W. GAGE, ESQ.

For Consolidated Casting Co.:

JAMES T. BYRNE, ESQ. [272]

Tuesday, October 30, 1951—10:30 A. M.

The Referee: We will now take up the Superior Casting Company case.

Mr. Blonder: Your Honor, this morning we have a hearing on the offer of compromise. Is there objection, Mr. Seymour and Mr. Gage?

Mr. Seymour: There is. We have filed objections to it, and have served a copy on Mr. Blonder.

Mr. Blonder: The copy was served on me in the courtroom this morning.

The Referee: I have gone over this. I am in favor of the compromise. But if this creditor wants to assume the burden of contesting the matter, it can, and can take its chances. I am going to rule in favor of the compromise.

Mr. Seymour: I appreciate your Honor's views. But it happens that we are all out of money and we have nothing left to put up a bond with.

Mr. Blonder: The same position was taken when these same gentlemen attempted to prevent the sale of the real estate for \$75,000. At that time they said they didn't want it sold, because of certain things, and we told them that if they would come up with an offer of a certain amount in cash it might be different, and they came up with the same answer, "Fresh out of money." So we sold the property for \$75,000, and now they are complaining about the offer to [273] compromise. I would like to see something to back up these continuous complaints.

The Referee: I am not stating what I will do. Mr. Shutan, are you in favor of or against the compromise?

Mr. Shutan: I am in favor of the compromise.

Mr. Blonder: I think there are some creditors in the courtroom also that the Court may be interested in hearing from.

Mr. George B. Kay: The American Smelting & Refining Company, approximately \$25,000.

The Referee: You have the same privilege, if you want to guarantee that amount to the estate or to take over the burden of litigating this matter.

Mr. Kay: I would be in favor of it, but I don't want to take it over.

The Referee: I have seen too many offers of this kind that came to nothing, because of a situation

like this, unless some creditor wanted to take the burden over.

Mr. Blonder: Are there any other creditors in the courtroom? (Pause.) Evidently not.

Mr. Seymour: I want your Honor to understand everything that is going to take place. We are going to review this matter.

The Referee: You don't have much chance, because all the decisions are against you.

Mr. Seymour: May I make a short argument, then, that [274] may have some weight?

The Referee: No use making an argument. If you can take over the burden here, all right. Otherwise I am going to approve this compromise.

Mr. Seymour: Even though, your Honor, on the facts stated in the petition, I can demonstrate to your Honor that they are not entitled to do it? Will your Honor listen to me?

The Referee: I can't help it. We have got the offer.

Mr. Seymour: Even if I can show your Honor that we can get, under the law, under the facts admitted—

The Referee: I don't know what might come out of the litigation. Nobody knows. The outcome of a lawsuit can never be demonstrated in advance.

Mr. Seymour: Let me make about a two or three-minute speech here. I like to make speeches.

The Referee: All right.

Mr. Seymour: The evidence that has been partially adduced before this Court is to the effect that there was a fraud in connection with the sale of

this chattel mortgage. I don't know whether your Honor happened to be in the courtroom when that evidence was taken.

The Referee: There is no evidence of fraud yet.

Mr. Seymour: Your Honor hasn't been here and heard it all.

The Referee: Just answer my question.

Mr. Seymour: There has been evidence of substantial [275] fraud here.

The Referee: Before me?

Mr. Seymour: The Court started it, and then there was a 21-A examination, and whether or not Mr. Blonder pointed the situation out to you I don't know, but I would like to point it out to you.

Mr. Blonder: You said sometime previously that there were no 21-A examinations. Are you stating now that there were?

Mr. Seymour: I am stating they were partially conducted. The point is that there is evidence before this Court under that 21-A examination, and Mr. Blonder knows it.

The Referee: I know all that. But do we want to lose this offer?

Mr. Seymour: I am going on this assumption, that there is evidence—

The Referee: I don't care about that. Suppose we follow your course, and in the end we lose. Do you mean to say that we will then lose the benefit of this compromise offer? That is what I want to know. There is a prior case on this.

Mr. Seymour: I don't think so.

The Referee: Now, stick to that. You have an opportunity to guarantee this thing and take it over.

Mr. Seymour: May I ask your Honor if your Honor is familiar with the fact that there was a bid of \$9,000 made [276] for this chattel mortgage property, and that the bidders, to wit, Consolidated Casting, and the agents in charge at that sale, paid one bidder \$1,000 not to make a bid? Is your Honor familiar with that?

Mr. Blonder: I stated to your Honor in my opening statement that that would be the evidence we would adduce. All the facts upon which the Trustee based his objection to the claim of \$64,000 were certainly adduced before your Honor on the trial. After the morning session they came through with this offer. The offer is \$20,000 in cash, plus \$1,500 to be deducted from the amount of the Bill Lepper claim, so, in effect, the estate is gaining \$21,500. That is the net result of the offered compromise.

The Referee: You have your remedy here.

Mr. Seymour: I would like to have your Honor read the case of Metheney vs. Davis, 107 Cal. App. page 137, which holds that where there has been fraud in connection with a chattel mortgage, that the holder of that obligation is not entitled to recover.

The Referee: Well, then, you take it over.

Mr. Seymour: I don't have \$21,000.

The Referee: Then the petition is granted. Objection overruled.

Mr. Blonder: May the record show that there

was a creditor in the court approving it, the creditor being American Smelting & Refining Company, Federated Metals [277] Division of American Smelting & Refining Company, whose claim is approximately \$25,000? That is represented by Mr. Kay. This creditor is an unsecured creditor.

Mr. Seymour: May the record also show that demand was made upon the Trustee that objections be brought to that very same claim that counsel is talking about.

The Referee: All right.

Mr. Blonder: Your Honor, with reference to the demand this morning, would it be appropriate at this time for the Trustee to make a motion to strike that demand, for the reason that it does not state any facts sufficient to constitute the basis for the claim of Mr. Seymour is asserting?

The Referee: I would rather you would get a formal order.

Mr. Blonder: These documents were filed this morning, and this is the first time we have seen them.

Mr. Seymour: I would like to have findings.

Mr. Blonder: I will submit them for approval, and if they are not good enough, I am sure somebody can correct them. I am wondering if, in view of the fact that Mr. Seymour threatens review, if it might not be advisable to take testimony in the matter.

The Referee: You can do whatever you want to.

Mr. Seymour: May we offer testimony, too, your Honor?

The Referee: I am not deciding this now. I am giving the objecting creditor or creditors the right to take this [278] litigation over, provided they will guarantee this estate in the end that it will protect the estate, so that, in the end, the estate will get this much.

Mr. Blonder: I believe we should include that particular phase of it in the findings, then. I will make it part of the order, that if the petitioning creditors want to take over the litigation—

The Referee: The order can provide that they were given that privilege, but that they refused to take it over.

Mr. Blonder: May I ask at the present time if Mr. Gage, who represents certain other objecting creditors, whether or not he, on behalf of his clients, also refuses this offer which is being given to him by the Court?

Mr. Gage: That is correct.

Mr. Blonder: May the record show that Mr. Gage also refuses the offer suggested by the Court?

The Referee: Mr. Seymour and Mr. Gage object.

Mr. Seymour: I will take it over if we don't have to put up \$21,000.

The Referee: Well, you don't want to put up anything. You want the other creditors to gamble with you, and they don't want to. Of course, you wouldn't have to put up cash. You could put up a bond.

Mr. Seymour: I couldn't get a 25-cent bond.

Mr. Blonder. The California By-Products is

certainly substantial. They can put up the [279] bond.

The Referee: If you want to try to get a bond, I will give you opportunity.

Mr. Seymour: I wouldn't risk \$21,000 on it, because I don't have it. If I had to pay, I couldn't pay it.

The Referee: If you want time to take it up with the creditors and see if they will do that—

Mr. Seymour: We are not going to put up any bond.

The Referee: Do you want time?

Mr. Seymour: I don't want time for that, no, your Honor.

Mr. Blonder: May I ask Mr. Byrne, who represents Consolidated Casting Company, to make the statement that he has \$21,000 in cash or cashier's check?

Mr. Byrne: I have here, your Honor, my check which is certified, in the sum of \$20,000, made out to Frank Chichester. That is on the condition that this is a final settlement.

The Referee: It has got to be in final settlement.

Mr. Shutan: I understand that Mr. Seymour filed certain papers in connection with objections to this hearing, and intends to file other papers. I would like the record to show my request and demand on Mr. Seymour that I receive copies of all pleadings and papers.

Mr. Seymour: May the record show that it is a pleasure.

Mr. Byrne: May the record show that I am

260 *California By-Products Corp., et al.,*

handing [280] Mr. Chichester this check, No. 446, and it is written on my client's account, James T. Byrne's client's account, and certified by the Bank of America, in the sum of \$20,000.

Mr. Chichester: The Trustee acknowledges its receipt. I will deposit it in my Trustee Account and hold it.

The Referee: It will be clear that I am not deciding this matter at all, other than to grant this petition, unless some creditor or creditors are willing to guarantee this amount to the estate and take over the burden of the litigation.

Mr. Byrne: I understand this acceptance this morning makes it a final acceptance?

The Referee: It does, by the Trustee. I don't think you need to have much fear of that, because this Court and other courts have universally held that that is subject to the sound discretion of the Referee and will not be reversed except in case of plain abuse of discretion. If anybody can find abuse of discretion in the orders I make in that respect, they are welcome. Anything else on that?

Mr. Blonder: In this Superior Casting case, we have three 21-A examinations, in which I would like to examine Mr. Gage, Mr. Seymour, and Mr. John Gray.

(21-A examination of Mr. Gage omitted.)

The Referee: Mr. Blonder, Mr. Seymour and Mr. Gage have filed a demand upon the Trustee that actions be brought and objections to the proposed compromise, in which they [281] accuse you of neglect.

Mr. Blonder: That is the second time.

The Referee: Do you want to make a statement in regard to that?

Mr. Blonder: I would like to make a motion to strike that demand.

The Referee: No, I wouldn't grant that. But do you want the record to show what you have done in these matters, and why?

Mr. Blonder: In the first place, if there is anything we haven't done, it is because Mr. Seymour and Mr. Gage have deliberately refused to disclose information to us, and that is the reason we have had to bring 21-A proceedings to get information. We have examined, under 21-A proceedings, I believe, all the witnesses mentioned in that demand. If there is any witness that we didn't examine, the Trustee was still satisfied that he had sufficient information and could develop sufficient testimony on the hearing on objections on the Bill Lepper claim. The purpose of filing the objections to the Bill Lepper claim was to attempt to knock out completely their claim of \$64,000. And that is what I understand Gage and Seymour want us to still do over again. We started that litigation, and now we are attempting to compromise. We think this is a reasonable compromise and suggest that it be accepted.

Insofar as the previous statement which they filed is concerned, accusing us of neglect, there was no neglect. [282] What Mr. Seymour and Mr. Gage didn't understand was that I was deliberately waiting for Bill Lepper to file his petition seeking the

262 *California By-Products Corp., et al.,*

\$64,000, before I started by proceeding. As soon as they filed that petition, we conducted all these examinations sufficiently to, in my opinion, give us enough ammunition to conduct the lawsuit. Now the offer of compromise has come up, and they don't like it. They filed a demand to start litigation, and I state that, if all the facts they set forth in their demand are true, there is still evidently no cause of action. So that is the story, your Honor. We have done all we can.

The Referee: Have you examined this petition? Do you want to make a statement about it? Read that.

Mr. Blonder: I haven't examined that thoroughly.

The Referee: Well, you had better do that.

Mr. Blonder: All right, your Honor.

The Referee: We will recess for 10 minutes.

(Short recess.)

Mr. Blonder: Two documents were filed. One is objections to the proposed compromise, and one is a demand upon the Trustee that actions be brought. Does the Court desire a statement on both documents?

The Referee: Whatever you want to say.

Mr. Blonder: With respect to the purpose of the proposed compromise, the Court has read the verified petition of the Trustee. The only thing I want to say with [283] reference to the objection is that the accusation has been made that the Trustee failed to examine fully, or, in some cases, at all, various witnesses who have knowledge of the asserted fraud

on the part of Bill Lepper Motors, Inc., and, of these witnesses, I want to state for the record that I personally examined or interviewed Mr. Les Scherer, Mr. Walter Smith, Mr. Falkenberg, the president of Consolidated Casting Company, Mr. Harold J. Ackerman, Mr. George Kay and Mr. John Gray. There were also other witnesses who were examined under 21-a, or interviewed by myself, and those witnesses gave me sufficient information to institute the proceeding which is the basis for the petition to compromise. I did not either interview or examine Mr. Norton Sather, Mr. William Cullen or Mr. Homer Lewis. If it had been necessary those three individuals would have been subpoenaed for the hearing before the Court.

The Referee: Why didn't you examine them?

Mr. Blonder: With reference to Mr. Norton Sather, we did not discover who he was or where he was until the last 21-A proceedings, when I examined Mr. Laughlin. That was a few days before the hearing before the Court, and we knew who he was at that time. He was, we understood, working for Consolidated Casting, and he could have been gotten here within a few hours, which we would have done, if the proceeding had required it.

With reference to Mr. William Cullen and Mr. Homer [284] Lewis, I still don't know who they are. And I will state to the Court that I had several interviews with Mr. Seymour and Mr. Gage and attempted to get information concerning this

matter, and at no time did they ever mention to me the name of William Cullen or Homer Lewis.

But, be that as it may, your Honor, and going on now to this demand upon the Trustee that he institute certain actions, an analysis of this demand shows that what Messrs. Gage and Seymour are seeking is that some sort of action be instituted confirming all these transactions which are at issue in the matter which is now before the Court, and which is the basis for the petition to compromise. Sufficient facts have been set up by the Trustee in his answers and affirmative defenses to the claim of Bill Lepper Motors for \$64,000. We set up, and are prepared to prove, those facts. The Court might not have agreed with our theory of the law. And it was in that particular proceeding that the petition to compromise has now been brought. The Trustee has already instituted the very proceedings which Gage and Seymour say now we should do, but they say we haven't done it quite the way they want us to do it. They probably want us to institute primary proceedings. That was one of the reasons why I wanted to wait until Bill Lepper instituted a proceeding in this court to get the \$64,000. In that way, by merely attacking his claim and setting up the affirmative defenses, we had the matter at issue before this Court on a [285] summary proceeding.

I will state to the Court also that I plan to file a written answer to this demand, so that the record will be clear on the point. And with reference to the pending proceedings now, I have one witness

to examine, Mr. John Gray, which will take only about five minutes. I want to find out what he knows about this situation.

Mr. Seymour: The hearing on the Lepper matter was continued to November 1st, at which time various witnesses were requested to return again unless they were notified to the contrary.

Mr. Blonder: I intend to do that.

Mr. Seymour: Mr. Gage and I would like to examine Messrs. Smith and Scherer at a 21-A examination, and I think it would be better that the Trustee would merely not notify them not to return on November 1st, and give us an opportunity to examine them.

Mr. Blonder: They were subpoenaed as witnesses.

The Referee: Have they been examined?

Mr. Blonder: They have not been examined, because we were just getting to that. I will be glad to examine them, if these creditors want that done, and I will call them and tell them that they have to be here then.

Mr. Seymour: Mr. Falkenberg, of Consolidated Casting, is another witness.

Mr. Byrne: The reason we offered the compromise was [286] because we—

The Referee: You need not go into that. If the creditors think the witnesses should be examined, and if you have no objection, go ahead.

Mr. Blonder: I have no objection. I know that, as far as Mr. Scherer and Mr. Smith are concerned, they will definitely testify as to the impropriety and

the fraudulent acts which occurred at the chattel mortgage foreclosure sale. Mr. Gage, I understand, has a letter from them to that effect. And so we are going to use them as witnesses in that particular hearing, and they are still under subpoena. I have no objection to examining them.

Mr. Byrne: On the offer of compromise, one of the prime motives of my offering this compromise, one of my prime purposes, was to stop the personalities. That is the reason I made the offer.

The Referee: Well, they can certainly examine these witnesses.

Mr. Byrne: But the matter has been compromised; they either accept my compromise, or they do not.

Mr. Blonder: May we ask Mr. Seymour and Mr. Gage what they think the Trustee may accomplish by examining these three witnesses? I disclosed what I know those witnesses will testify to. I disclosed what I will examine them about. I disclosed what I think they know and what they will testify to. I think it would be most appropriate for Mr. Seymour and [287] Mr. Gage to advise the Trustee, since he wants us to examine them, to tell us what they want to find out from these three individuals. I think it would be interesting to know that fact.

Mr. Seymour: You stated that it was your opinion that their testimony would be that the sale on the chattel mortgage was, in essence, fraudulent.

Mr. Blonder: Right.

Mr. Seymour: That is the purpose of my examination. If you will stipulate that that is what their

testimony would be, I will dispense with the examination.

Mr. Blonder: Mr. Seymour, or Mr. Gage, has letters in his possession—I want the record to show that Mr. Gage has letters in his possession, by Scherer and Smith, which state what they will testify to. He never showed them to me when I had him on 21-A proceedings several weeks ago, and he didn't tell me anything about it. If you want to know what they are going to testify to, let's see what they say. They have got it in writing, your Honor.

Mr. Seymour: I want to have their testimony as a part of the record.

The Referee: That is denied. I am not trying any issue raised on these charges. I am simply holding that this is a substantial offer, and I am going to approve it, unless you want to take over the litigation and guarantee that the estate will get that amount. [288]

Mr. Gage: Is it my understanding, your Honor, from what you said, that you are not concerned with whether there was fraud there or not?

The Referee: It isn't a question of my concern. It is a question of whether you want to take over the litigation or whether you don't.

Mr. Gage: That is your order?

The Referee: That is my order. That is not denying you any right whatever, provided you guarantee that the estate will get this money.

Mr. Blonder: May I proceed with the examination of Mr. Gray, your Honor?

The Referee: All right.

Mr. Blonder: May I ask you, for the record, Mr. Seymour, do you know anything about Superior Casting Company of Texas which would enable the Trustee to get together any assets or funds for the benefit of the present bankrupt estate?

Mr. Seymour: I know nothing more than what Mr. Gage testified to. What I do know I learned from him.

Mr. Blonder: All right. I am satisfied, for the record. Now, Mr. Gray.

(Examination of the witness John D. Gray omitted.)

Mr. Seymour: Do I understand, your Honor, that these witnesses Scherer and Smith will be examined, the witnesses I mentioned before, Scherer and Smith, that we will have an [289] opportunity to examine them on the first?

The Referee: If you can uncover any assets, yes. Otherwise it is a waste of time. But I am not going into the merits of the thing.

Mr. Seymour: We are desirous of knowing their testimony and having it in the record. We do have an affidavit as to what they would say, and would like to have it in the record—that is Scherer and Smith and Falkenberg.

Mr. Chichester: That is in connection with the compromise?

The Referee: I am not concerned—

Mr. Seymour: But we are—

The Referee: Sit down. I am not concerned with

all these charges. Unless you can take over the litigation and guarantee that money to the estate, it would shock the conscience of any equity judge to do otherwise.

Mr. Seymour: For the record, I request that we be permitted to examine Mr. Walter Smith, one Les Scherer—I don't know Falkenberg's first name.

Mr. Blonder: William.

Mr. Seymour: And William Falkenberg, for the purpose of demonstrating by their evidence that the sale under the chattel mortgage was fraudulent.

The Referee: Maybe it is. I don't know.

Mr. Seymour: Well, but I want to get that in the record, and I request an opportunity to examine them for the [290] purpose of putting their evidence on the record.

Mr. Blonder: I have no objection, but it may hold up—I don't want that to hold up the compromise.

Mr. Chichester: I am afraid the compromise might be [291] lost. I have a \$20,000 certified check in my possession, that I want to deposit to the account of the bankrupt estate. One of the reasons for making that offer in compromise was to terminate further litigation and further examination of witnesses, and a possible strain on friendship between individuals in this matter. That is one of the reasons why we have a substantial offer. If that offer is going to be jeopardized by trying to keep open these apparent wounds and bringing the whole matter back to the surface again, we can very well lose the compromise.

The Referee: I agree with that.

Mr. Blonder: May I suggest that we go ahead with the compromise, and your Honor rule, and if, at any later date, we have to examine these witnesses, they are still open for 21-A examination.

Mr. Gage: I take it, then, that this Court, for purposes of this compromise, is not interested as to whether there was any fraud in the sale or not?

The Referee: I am going to give you a chance to go into it in the proper way, if you want to.

Mr. Gage: Just by bringing it up under 21-A, your Honor?

Mr. Seymour: Just by putting up \$21,000, your Honor?

The Referee: Well, I can't help that. I am not going to let you use the process of this court and ball this thing up so that we will get nothing in the end. [292]

Mr. Gage: Has the Court any objection to Mr. Seymour and myself examining those two witnesses under 21-A tomorrow, before the date set for the compromise to be heard, November 1st?

Mr. Blonder: That November 1st date is just a continuation of the litigation itself.

The Referee: If it is anything that would jeopardize the compromise, we won't do it.

Mr. Chichester: I think that is right, your Honor.

Mr. Seymour: In other words, we may not do that, we may not examine any of these witnesses?

The Referee: That's right, upon the ground, solely, that this compromise is intended to eliminate all that.

The offer is very substantial. And if you think you can do better by an assumption of the litigation, you can have the opportunity to take it over. You have refused to do so.

Mr. Seymour: I refused on one ground only, that I didn't have \$21,000.

The Referee: We can't jeopardize the creditors by doing it. [293]

Certificate

I, C. W. McClain, hereby certify that on the 30th day of October, 1951, I attended and reported, as official court reporter, the proceedings in the above-entitled and numbered matter before the Honorable Reuben G. Hunt, Referee in Bankruptcy, in said Matter, and that the foregoing is a true and correct transcript of the proceedings had therein on said date and that said transcript is a true and correct transcription of my stenographic notes thereof.

Dated at Los Angeles, California, this the 13th day of November, 1951.

/s/ C. W. McCLAIN,
Official Court Reporter.

[Endorsed]: Filed November 13, 1951, [294]
Referee.